

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JOSEPH PASQUINO	:	DETERMINATION
	:	DTA NO. 815731
for Redetermination of a Deficiency or for Refund of	:	
Personal Income Tax under Article 22 of the Tax Law for	:	
the Period July 1, 1990 through June 12, 1994.	:	

Petitioner, Joseph Pasquino, c/o Kalkstein & Co., 144 Albany Post Road, Buchanan, New York 10511, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the period July 1, 1990 through June 12, 1994.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on December 4, 1997 at 10:00 A.M., with all briefs submitted by March 2, 1998, which date began the six-month period for the issuance of this determination. Petitioner appeared by Lawrence Kalkstein, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Herbert M. Friedman, Jr., Esq., of counsel).

ISSUE

Whether the Division of Taxation properly determined that petitioner was liable for penalties of 100% of Beta Growth Network, Inc.'s unremitted withholding taxes pursuant to Tax Law § 685(g) and (n).

FINDINGS OF FACT

1. On May 28, 1996, the Division of Taxation (“Division”) issued to petitioner, Joseph Pasquino, three notices of deficiency¹ which asserted, in total, \$53,998.87 in penalty due from petitioner pursuant to Tax Law § 685(g). Specifically, notice number L012087146 asserted \$36,958.77 in penalty due for the period June 30, 1993 through September 29, 1993; notice number L012087145 asserted \$16,887.22 in penalty due for the period October 18, 1993 through December 29, 1993; and notice number L012087147 asserted \$152.88 in penalty due for the period March 30, 1994 through June 12, 1994. The penalty asserted in the notices was premised on the failure of the Beta Growth Network, Inc. (“BGN”) to remit to the Division withholding taxes as reported for those periods.

2. BGN was a construction company. During the relevant period BGN worked exclusively as a subcontractor on projects for the City of New York and the New York City School Construction Authority. The general contractor on the City of New York project was a corporation referred to in the record as Kruger Construction Company. The general contractor on the School Construction Authority project was Herbert Construction Company.

3. Petitioner has been in the construction business for about 40 years. He became involved with BGN in approximately April 1993 when the former principal of BGN advised petitioner that the corporation had financial problems and asked petitioner to loan money to the corporation. Both petitioner and the former principal of BGN understood that petitioner would have a voice in the corporation’s operations if he were to loan money to the corporation. Petitioner did loan money to BGN at that time. In total, according to BGN’s bankruptcy petition (*see*, Finding of

¹ The Division also issued a fourth Notice of Deficiency to petitioner on May 28, 1996 (notice number L012087148). This notice was canceled by a Conciliation Order dated March 14, 1997. The Conciliation Order sustained the notices referenced above.

Fact “6”), petitioner “advanced and raised capital” for BGN of approximately \$750,000.00. Of that amount, \$157,000.00 was repaid by BGN in 16 payments made between June 21, 1993 and December 28, 1993. The balance of the funds loaned by petitioner to the corporation was not repaid, as the bankruptcy petition lists petitioner as an unsecured nonpriority creditor with a claim of \$399,400.00 against the corporation.²

4. At about the same time petitioner loaned money to the corporation, he became actively involved in its day-to-day operations.³ Petitioner became secretary of BGN and devoted the majority of his time to the corporation’s affairs. At the time, BGN was having cash flow problems. Specifically, the general contractor on one of BGN’s projects, Herbert Construction Company, was late in paying BGN for services provided. Petitioner negotiated with Herbert Construction and the New York City School Construction Authority to secure payment for BGN for services rendered. In addition, because of this delay in payment, BGN was late in paying its suppliers and subcontractors. Petitioner negotiated with BGN’s creditors in an effort to obtain more time to pay and to reduce the amount of the debts. Petitioner’s efforts resulted in “Vendor’s Estoppel Agreements” between BGN and various vendors which certified the amount of the debt owed by BGN to such vendors. Petitioner also obtained waivers from some vendors on liens held by such vendors. Petitioner determined which of BGN’s creditors were paid. He had authority to sign checks on behalf of BGN and did sign checks in payment of creditors. In

² Petitioner testified that he loaned BGN \$200,000.00 and that no part of the loan was repaid. This testimony is rejected in favor of information contained in BGN’s bankruptcy petition which indicates loans totaling \$750,000.00 and repayments totaling \$157,000.00.

³ Petitioner testified that he became involved in the operations of BGN only after the corporation defaulted on his loan. This testimony is rejected in light of petitioner’s testimony that he became involved with BGN with the understanding that he would have a voice in its operations; the fact that petitioner took control of BGN’s operations at about the same time he made the loan (there having been very little time for a default to have occurred); the fact that BGN commenced repayment to petitioner in June 1993; and the lack of any testimony regarding when the default occurred.

addition, in an effort to resolve petitioner's late payment and nonpayment of its creditors, and as a result of petitioner's negotiations with Herbert Construction, Herbert issued several checks jointly payable to BGN and various suppliers and subcontractors of BGN.

5. During the period at issue, BGN withheld New York State income taxes from its employees' paychecks. At the same time, however, BGN did not pay such withholding taxes over to New York State. BGN also did not timely file its withholding tax returns during this period. Petitioner was aware that BGN was withholding taxes from its employees' paychecks, and that BGN was not remitting such taxes or timely filing withholding tax returns during this period.

6. BGN filed a petition in bankruptcy under Chapter 11 of the United States Bankruptcy Code on January 18, 1994. Petitioner signed the petition on behalf of BGN.

7. At about the same time, BGN filed its quarterly combined withholding and wage reporting returns for the two quarters comprising the period July through December 1993. Petitioner signed such returns on behalf of BGN. Petitioner filed these withholding tax returns on behalf of BGN in order to proceed with the bankruptcy. BGN later filed its Quarterly Combined Withholding and Wage Reporting Return for the quarter April through June 1994 on or about July 20, 1994. This return was filed unsigned.

8. Petitioner also signed BGN's quarterly combined withholding and wage reporting returns for the quarters January through March 1993 (dated September 24, 1993) and April through June 1993 (dated December 1, 1993). These two returns reported zero tax withheld and therefore did not give rise to any penalty assessments.

9. BGN's bankruptcy case was converted to a Chapter 7 liquidation on or about May 10, 1995. BGN's Chapter 7 case was closed pursuant to an Order of Final Decree dated August 18, 1995.

10. Petitioner did not receive any salary as secretary of BGN.

11. It is uncertain whether petitioner received stock in BGN. The bankruptcy petition indicates that the shares of the former principal of BGN were to be collateral for the loans made by petitioner to the corporation. Petitioner testified as to his understanding that he was to receive some percentage of corporate stock when he first became involved in BGN. Petitioner was uncertain, however, whether he ever actually received any corporate stock.

12. According to newspaper reports received in evidence, in July 1995 the owner of the Herbert Construction Company was charged with receiving more than \$7,000,000.00 in kickbacks from subcontractors. There is no evidence in the record linking this alleged activity and Herbert's failure to timely pay BGN for services rendered.

13. Petitioner testified that Herbert paid BGN's employees directly at about the time BGN ceased operations. Petitioner was uncertain when such direct payment by Herbert occurred, however, and stated that it may have occurred after BGN's bankruptcy case was closed. There is insufficient evidence in the record to find that BGN's employees were paid by Herbert during the period at issue.⁴

CONCLUSIONS OF LAW

⁴ This finding is based on petitioner's equivocal testimony as to when this direct payment may have occurred, and the fact that the withholding tax assessment is based on BGN's filed returns (i.e., BGN would not have reported that it withheld tax where employees were paid by Herbert).

A. In order for the State to hold an individual liable for penalties of 100% of the unremitted withholding taxes, the individual must be a “person” who acted “willfully” under Tax Law § 685(g) and (n) in his or her failure to remit the appropriate withholding taxes. Section 685(g) provides:

[a]ny person required to collect, truthfully account for, and pay over the tax imposed by this article who willfully fails to collect such tax or truthfully account for and pay over such tax . . . shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

The definition of “person” for purposes of Tax Law § 685(g) is contained in Tax Law § 685(n). The definition of “person” as set forth in that section includes “an officer or employee of any corporation (including a dissolved corporation) . . . who as such officer [or] employee . . . is under a duty to perform the act in respect of which the violation occurs.”

B. It is well established that the question of whether someone is a “person” required to collect and pay over withholding tax is a factual one. Factors considered are whether the individual in question signed the corporation’s tax returns, derived a substantial part of his or her income from the corporation, or had the right to hire and fire employees (*Matter of Malkin v. Tully*, 65 AD2d 228, 412 NYS2d 186, 188; *Matter of MacLean v. State Tax Commn.*, 69 AD2d 951, 415 NYS2d 492, 494, *affd* 49 NY2d 920, 428 NYS2d 675). Other relevant factors include the person’s official duties, the amount of corporate stock owned, and the authority to pay corporate obligations (*Matter of Amengual v. State Tax Commn.*, 95 AD2d 949, 464 NYS2d 272, 273; *Matter of McHugh v. State Tax Commn.*, 70 AD2d 987, 417 NYS2d 799, 801).

C. The record in this matter indicates that petitioner was a “person” within the meaning of Tax Law § 685(n). Petitioner was an officer of BGN. More importantly, from the time he became involved with BGN, petitioner controlled the corporation’s financial affairs. He

negotiated with BGN's creditors and general contractors. He had check signing authority. In short, petitioner determined which of BGN's creditors were paid and which were not.

Significantly, while he was in control, BGN made 16 payments to petitioner in repayment of loans, notwithstanding BGN's failure to make any payments of withholding tax during the same period. Petitioner also signed BGN's withholding tax returns and its bankruptcy petition.

Petitioner asserted that he signed the tax returns to enable BGN to file for bankruptcy and that, therefore, the fact of his signing is not indicative of responsible officer status. Contrary to petitioner's assertion, it appears that petitioner signed the returns for the quarters January through March and April through June 1993 well in advance of BGN's bankruptcy filing (*see*, Finding of Fact "8"). The signing of returns for those two quarters would thus appear to be unrelated to the bankruptcy filing. Furthermore, the finding herein that petitioner was a responsible officer of BGN is not based on "the mere filing of withholding tax returns" (Petitioner's brief p. 2), for no single factor is determinative in finding an individual to be a responsible officer (*see, Matter of DeFeo*, Tax Appeals Tribunal, March 9, 1995). Petitioner's signing of the returns is clearly one factor indicating that petitioner was under a duty to collect and remit withholding taxes on behalf of BGN, petitioner's reason for signing and filing such returns notwithstanding. In this case, however, petitioner's signing of the returns is less significant than his control of BGN's finances during the period at issue.

Petitioner also argued that the true culprit in this matter was Herbert Construction Company because of Herbert's failure to pay BGN in a timely fashion and because the criminal charges against Herbert made it impossible for BGN to recover the balance (unspecified in amount) it was owed. Petitioner argued that the Division's pursuit of petitioner under such circumstances was unfair. Economic difficulties are not an excuse for the failure to pay

withholding taxes (*see, Matter of Dworkin Construction*, Tax Appeals Tribunal, August 4, 1988). Accordingly, petitioner was not relieved of his responsibility to act on behalf of BGN in respect of its withholding tax obligations because of the cash flow problems. Furthermore, there is no evidence in the record linking the criminal charges against Herbert's owner and Herbert's failure to pay BGN in a timely manner. There is also no evidence in the record as to the amount, if any, that BGN was unable to collect from Herbert. Finally, it is noted that petitioner easily could have satisfied BGN's withholding tax obligations from the BGN assets that were used instead to repay petitioner's loans.

D. Next it must be determined whether petitioner acted "willfully" in his failure to remit the appropriate withholding taxes to the State. The test for willfulness in this context is well-established:

[T]he test is whether the act, default, or conduct is consciously and voluntarily done with knowledge that as a result, trust funds belonging to the Government will not be paid over but will be used for other purposes No showing of intent to deprive the Government of its money is necessary but only something more than accidental nonpayment is required. (*Matter of Levin v. Gallman*, 42 NY2d 32, 396 NYS2d 623, 624-625.)

E. Petitioner's failure to remit the withholding taxes of BGN during the period at issue meets the willfulness standard articulated above. Petitioner knew that BGN was not paying its withholding taxes during the period at issue and, at the same time, directed that available funds be used to pay other creditors, including himself. This clearly constitutes willfulness for purposes of the section 685(g) penalty.

Petitioner contended that his conduct was not willful because payment of the withholding taxes at issue would have been a violation of New York Lien Law, Article 3-A. Petitioner asserted that the statutory lien creditors under that article had priority over New York. This

contention is rejected. Article 3-A of the Lien Law provides that all funds paid to a contractor in connection with the improvement of real property constitute assets of a trust for benefit of, among others, subcontractors, laborers, materialmen, and tax claims (*see*, Lien Law §§ 70-79-a). Under Lien Law § 77(8), the State is designated a trust beneficiary for unpaid taxes and is given priority in the distribution of trust assets.⁵ It would thus appear that BGN's payment of the withholding taxes at issue would not have violated Article 3-A of the Lien Law.

Petitioner also contended that payment of the withholding taxes at issue would have been in violation of the U.S. Bankruptcy Code. There is no evidence in the record, however, that the Bankruptcy court or any trustee ever directed BGN not to pay its withholding taxes (*see, Matter of Byram*, Tax Appeals Tribunal, August 11, 1994). Accordingly, this contention is also rejected.

F. The petition of Joseph Pasquino is denied and the notices of deficiency, dated May 28, 1996, are sustained.

DATED: Troy, New York
August 20, 1998

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE

⁵ The State's status as beneficiary for taxes with respect to such a trust is limited to taxes accrued on the particular job which is the subject of the trust (*St. Paul Fire and Marine Insurance Co. v. State*, 99 Misc 2d 140, 415 NYS2d 949, 952).